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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 639

**ESTATE OF MORTIMER B. FULLER, DECEASED,
KATHRYN S. FULLER, EDWARD L. FULLER,
MORTIMER B. FULLER, JR., AND HENRY S.
FULLER, EXECUTORS, PETITIONERS**

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 7a-16a) is reported at 9 T. C. 1069. The opinion of the Court of Appeals (R. 30) is reported at 171 F. 2d 704.

JURISDICTION

The judgment of the Court of Appeals was entered on December 13, 1948 (R. 31). The petition for a writ of certiorari was filed on March 11, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that expenses of maintaining and operating a farm and homestead occupied by the executors as individuals are not deductible by the estate under Section 23 (a) (2) of the Internal Revenue Code as expenses incurred for the management, conservation, or maintenance of property held for the production of income, or under Section 23 (a) (1) as ordinary and necessary expenses incurred in carrying on any trade or business.

STATUTES AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*, pp. 13-17.

STATEMENT

The facts as found by the Tax Court (R. 7a-12a) may be summarized as follows:

Mortimer B. Fuller died on September 7, 1931. He appointed his wife, Kathryn S. Fuller, and his three sons, Edward L., Mortimer B., Jr., and Henry S. Fuller executors and trustees under his will. (R. 7a.)

The executors bought and sold securities from 1931 through 1943 and received income on the securities held. The executors also owned, during that period, various listed and unlisted securities whose value was at all times substantially greater than the debts of the estate. The indebtedness owed to banks and individuals was gradually

reduced and on December 31, 1943, amounted to \$520,822.73. The indebtedness to banks was increased \$12,553.17 during 1942. No steps, except the reduction of debts and the payment of some cash bequests, were taken during the period to close the administration. No accounts were filed in the Orphans' Court. (R. 7a-8a.)

Paragraph 4 of the decedent's will was as follows (R. 8a):

I give and bequeath to my wife, Kathryn S. Fuller, for and during the term of her natural life, all the furniture, pictures or other articles contained in my home situate in the Borough of Dalton and Township of North Abington, County of Lackawanna, or elsewhere, also all horses, cattle, or other animals, carriages, harnesses, and motor vehicles owned by me at the time of my death. I also give, devise and bequeath to my wife for and during the term of her natural life my said home in the Borough of Dalton and Township of North Abington, together with the grounds and other appurtenances thereto and the equipment thereof.

All of the residue of his estate he gave the trustees upon the following trusts (R. 8a-9a):

(a) To separate and set aside from the rest of my estate one portion thereof sufficient to produce an income of fifty thousand (\$50,000.00) dollars annually, and to use said income or so much thereof as may be needed for the maintenance and opera-

tion of my home known as "Overlook" situate partly in the Borough of Dalton and partly in the Township of North Abington, as aforesaid including the grounds and other appurtenances and all things incident thereto, for and during the term of the life of my wife, Kathryn S. Fuller. It shall be so maintained and conducted after the death of my wife out of said fund also as long as any one of my sons may so desire; but if one of my three sons should not desire it so maintained and conducted only two-thirds ($\frac{2}{3}$) of said fund shall be used annually for said purpose and the remainder shall become part of the trust funds hereinafter mentioned; and if two of my three sons do not desire it so maintained and conducted only twenty-five thousand (\$25,000.00) dollars of said income shall be used annually for said purpose and the remainder shall become part of the trust funds hereinafter mentioned;

(b) If at any time during the life of my wife, Kathryn S. Fuller, she and all my sons shall desire that said home, together with the grounds and appurtenances and things incident thereto, be sold, she and my trustees shall sell the same and the proceeds of said sale shall become part of my trust funds hereinafter mentioned, in the same proportion as hereinafter set forth;

(c) If after the death of my wife at any time my three sons, or they or he then surviving, shall decide to sell said home and grounds and appurtenances and things in-

cident thereto, my trustees shall sell the same and divide and distribute the proceeds equally among my son or sons then living and the children of any surviving son or sons per stirpes * * *

* * * * *

The remainder of his estate was given in trust during his wife's life in part to her and in part to his three sons, with appropriate provision for distribution on the death of the wife (R. 9a-10a).

One of the assets owned by the decedent at the time of his death was his home mentioned in paragraph 4 of his will. It was a country estate called "Overlook". It had been the family home since 1905 when the decedent's father acquired it. It consisted of about 518 acres divided as follows (R. 10a):

Description:	Acres
Pasture and cultivated land.....	150
Landscaped grounds and lawn.....	20
Timber land.....	204
Unimproved land.....	60
Lake	84

The main house on the property is large. A flower conservatory is attached to the house. The house has been occupied, at all times material hereto, by the decedent's widow. All of the decedent's three sons are married. They, with their families since their marriages in 1929, 1932, and 1934, have occupied three other houses on the property separate from the main house. No rent is paid by any of the four who are executors.

Another house on the property has been rented to an employee of International Salt Company at \$40 per month. There are also a number of houses and living quarters for employees and servants, a large trophy house, an indoor heated swimming pool, a Japanese tea garden, a frame boat house, a tennis court, and farm buildings on the property. There are three miles of 14-foot improved hard roads on the property. (R. 10a.)

The operation of Overlook during the life of the decedent and thereafter has always cost a substantial amount over and above the small income from the property (R. 10a).

The Fullers pay the expenses of their own households, such as food bills and servants' wages. The three brothers were respectively 36, 40, and 43 years of age in June 1947. (R. 10a.)

The executors paid the following amounts during the taxable years in connection with the Overlook property (R. 10a-11a):

	1942	1943
Pay roll.....	\$18,679.43	\$18,477.20
Light and coal.....	5,464.85	5,275.11
Horses and feed.....	1,610.00	3,902.23
Sundry expenses and supplies.....	1,116.64	981.15
Farm expense and equipment.....	1,860.07	2,610.95
Greenhouses and gardens.....	1,591.22	1,408.61
Auto repairs, etc.....	575.69	244.55
Oil and gas.....	1,556.80	556.78
Repairs and maintenance.....	575.69	2,147.91
Total.....	33,030.39	35,599.49

The totals shown above were not claimed as deductions on the returns filed for the estate for the years 1942 and 1943 (R. 11a).

The expenses relating particularly to the farming operations on Overlook, included in the figures shown above, were as follows (R. 11a):

	1942	1943
Labor	\$11,443.18	\$11,505.72
Fees	780.90	1,475.61
Seed, plant and trees	1,620.42	1,401.60
Supplies	1,042.11	1,000.30
Repairs equip't	244.47	188.67
Fertilizers and lime	420.63	178.00
Gasoline and other fuel	382.57	232.37
Insurance on prop.	1,565.48	362.88
Water, elec. and telephone	1,634.21	1,554.08
Freight and trucking	50.73	19.85
Rental paid	150.00	150.00
Misc. expense	399.82	256.30
Memberships and assns.	10.00	9.75
Tree sprays	—	480.75
Repair and maintenance bldgs	1,743.83	1,503.97
Depreciation	2,580.23	2,589.83
Total expenses	24,068.58	22,909.68

Income from rentals, and sales of produce and junk in the amount of \$1,055.33 for 1942 and \$2,352.13 for 1943, together with depreciation on farm buildings and equipment in the amount of \$2,580.23 for 1942 and \$2,589.83 for 1943 were used in connection with the farm expenses listed above to arrive at net farm loss of \$23,013.25 for 1942 and \$20,647.55 for 1943 which were deducted on the returns filed for the estate (R. 11a-12a).

The principal farming activity on Overlook has been to provide pasture and other food for a herd of dairy cows. The herdsman was given all of the revenue from the sale of dairy products, including that sold to the Fullers. He took

care of the herd and also spent some time working on the farm. He was not paid any wages. Most of the dairy products produced by the herd have been bought by the Fullers and their families from the herdsman at market prices. Excess dairy and farm products, if any, were sold to the public. The Fuller family usually took about 75% and about 25% was usually sold to the public. (R. 12a.)

About sixty acres of Overlook were sold at some time not disclosed by the record for about five or six thousand dollars. No sustained effort was ever made to sell any of the remainder of the property and no offer to buy any of it was ever received. (R. 12a.)

The Commissioner, in determining the deficiencies, disallowed the farm losses with the explanation that the loss from the operation of the farm was a personal expense not deductible for income tax purposes (R. 12a).¹ The Tax Court upheld the Commissioner's determination (R. 12a-16a) and the Court of Appeals affirmed, *per curiam*, upon the Tax Court's opinion (R. 30).

ARGUMENT

1. The holding of the courts below that the farm and residential property on which the widow

¹ The Tax Court seems to have used the term "losses" in a loose sense comprehending "expenses." In any event, the petitioners make no claim to a loss deduction under Section 23 (e), Appendix, *infra*, p. 14.

and the other executors resided were operated and maintained for their personal use and enjoyment and that the expenses incurred were not ordinary and necessary to manage, conserve, or maintain property held for the production of income so as to be deductible under Section 23 (a) (2), Internal Revenue Code, Appendix, *infra*, p. 13, or in connection with a business so as to be deductible under Section 23 (a) (1), Appendix, *infra*, p. 13, was clearly correct. Section 23 (a) (1) and (2) requires that the expenses be both "ordinary and necessary" (*Welch v. Helvering*, 290 U. S. 111). Here, the Tax Court concluded (R. 14a) that, there being no evidence to indicate that any effort was made to limit expenses to those necessary to conserve and maintain the property for any use incident to the administration of the estate, the "expenses were not ordinary or necessary expenses of the estate" (R. 13a).

The farm and property here involved were found to have been used "as a comfortable country estate" without any intention or expectation of deriving profit or income therefrom (R. 14a). Certainly when as here, the transactions were not carried on "*primarily* for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income" (Regulation 111, Section 29.23 (a)-15 (2) (b), Appendix, *infra*, p. 16, italics supplied), the expenses incident thereto

are not allowable deductions. The decision below is therefore in complete accord with the decided cases and the Treasury Regulations. *Trust of Bingham v. Commissioner*, 325 U. S. 365; *United States v. Pyne*, 313 U. S. 127, 131-132; *Coffey v. Commissioner*, 141 F. 2d 204, 205 (C. A. 5th); *Union Trust Co. v. Commissioner*, 54 F. 2d 199 (C. A. 6th); *Deering v. Blair*, 23 F. 2d 975 (C. A. D. C.); Regulations 111, Sec. 29.22 (a)-7, 29.23 (a)-1, 29.23 (a)-11, and 29.23 (a)-15, Appendix, *infra*, pp. 14-17.

2. The alleged conflict between the decision below and *Trust of Bingham v. Commissioner*, 325 U. S. 365, is non-existent. The taxpayer (Pet. 13) misconstrues the *Bingham* case as permitting the deduction of any ordinary expense incident to the duty of a trustee to hold and conserve property until final distribution. From this it is argued that the decedent's will here imposed the duty on the trustees to operate and maintain the realty in question and therefore expenses incurred (by the executors) in fulfilling this duty are likewise deductible. The *Bingham* case, however, involved property held by trustees "for the production of income", and it was ruled, *inter alia*, that the property did not cease to be so held when the trust term reached its expiry date. Here, however, the Tax Court found that the expenses in question were "for the quite different purpose of providing a country estate as a comfortable living place for the four indi-

viduals who are also executors." (R. 14a.) Since the *Bingham* case is grounded on a determination that property be held for the production of income, the taxpayer can find no support in the application of that rule to this case where the finding, apparently not now disputed, is that the property was not held for the production of income and the expenses were, in any event, neither ordinary nor necessary. See *supra*, p. 9.

3. The taxpayer asserts (Pet. 13) that the Tax Court has failed either in its Findings of Fact or its Opinion to make specific findings with respect to the alternative issue that the expenses involved are deductible under Section 23 (a) (1) as "ordinary and necessary expenses paid in carrying on the business of farming." But the Tax Court's lengthy discussion (R. 13a-15a) of the non-deductibility of (R. 13a) "annual farm losses as ordinary and necessary expenses of a business" in the light of its conclusion (R. 14a) that there was no evidence to "indicate that any effort was ever made to operate this farm profitably" and its quotation (R. 14a-15a) from the case of *Union Trust Co. v. Commissioner*, 18 B. T. A. 1234, which it thought apposite in view of the absence from the decedent's will of any indication that the farm be operated on a commercial basis, demonstrate the infirmity of the objection. The opinion may, of course, "perform the office of a finding of facts" (*Olson v. Commissioner*, 67 F. 2d 726, 728 (C. A. 7th), certiorari denied, 292 U. S.

637) and may be read in its entirety to determine the import of the decision and the facts on which it is based. (*Janeway v. Commissioner*, 147 F. 2d 602 (C. A. 2d); *Emerald Oil Co. v. Commissioner*, 72 F. 2d 681 (C. A. 10th); *Insurance & Title Guarantee Co. v. Commissioner*, 36 F. 2d 842 (C. A. 2d), certiorari denied, 281 U. S. 748). The opinion as a whole leaves no doubt as to the finding of the Tax Court against the taxpayer on the alternative issue. *United States v. Pyne*, 313 U. S. 127, cited by the taxpayer, is, with respect to this question, patently distinguishable on its facts.

CONCLUSION

The decisions below are correct and in harmony with the decided cases. There is no conflict and no need for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1949.

APPENDIX

INTERNAL REVENUE CODE

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business;

* * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) [as amended by Sec. 127 (b) of the Revenue Act of 1942, supra] *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23 (x);

* * * *

(26 U. S. C. 1946 ed., Sec. 24.)

TREASURY REGULATIONS 111, PROMULGATED UNDER THE INTERNAL REVENUE CODE

SEC. 29.22 (a)-7. *Gross Income of Farmers.*—

* * *

* * * *

* * * A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

* * * *

SEC. 29.23 (a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *

* * * *

SEC. 29.23 (a)-11. *Expenses of Farmers.*—

* * * If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. * * *

SEC. 29.23 (a)-15 [as amended by T. D. 5331, 1944 Cum. Bull. 98, and T. D. 5513, 1946-1 Cum. Bull. 61]. *Nontrade or Nonbusiness Expenses*—

(a) *In General.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above.

* * *. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby,

or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or

loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

* * * * *

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.¹

¹ Section 29.23 (a)-15 (b) of Treasury Regulations 111 was amended by striking out the fifth paragraph thereof and substituting this paragraph in lieu thereof. See T. D. 5331, 1944 Cum. Bull. 98 (approved February 9, 1944). It was also later amended by striking out the sixth, seventh, eighth and tenth paragraphs thereof and substituting, after the fifth paragraph, a single new paragraph in lieu thereof, which is immaterial herein. See T. D. 5513, 1946-1 Cum. Bull. 61-62 (approved May 14, 1946). Hence, the last two paragraphs of Section 29.23 (a)-15 (b) of Treasury Regulations 111, as quoted in the Record (pp. 3a-4a), are no longer in force.